

ST 02-0267-GIL 12/19/2002 SERVICE OCCUPATION TAX

The transfer of tangible personal property results in Service Occupation Tax liability rather than Retailers' Occupation Tax liability where the purchaser employs the seller primarily for its engineering skill to design and produce the property on special order, where the property has use or value only for the specific purpose for which it was produced and where the property has use or value only to the purchaser. See 86 Ill. Adm. Code 130.2155. (This is a GIL).

December 19, 2002

Dear Xxxxx:

This letter is in response to your letter dated August 27, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

We request a private letter ruling from the Department of Revenue stating that AAA is subject to the Service Occupation Tax and Service Use Tax rather than the Retailers' Occupation Tax on the housing components that it fabricates and sells.

No audit or litigation is pending. To the best of our knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor. Neither the taxpayer nor any representative has submitted the same or a similar issue to the Department and withdrawn it before a ruling was issued. We set forth herein the authorities which support our position. We believe that there are no authorities contrary to the view that the activities described are subject to the Service Occupation Tax and Service Use Tax rather than the Retailers' Occupation Tax.

AAA is in the business of fabricating and selling certain home components to builders. These components are roof truss systems, wall panels, floor decking and stairs. AAA understands that it will incur Use Tax on the material cost of the components which it fabricates and sells. AAA provides no installation of its products.

A roof truss system is a large wooded structure that spans the length and width of a house and supports the weight of the roof. The truss systems consist of all the individual trusses needed to support the roof. While a truss system may have two or more individual trusses which are identical, only the most simple roof would consist of duplicate individual trusses throughout. A truss is comprised of many triangles of different shapes framed together. Each member of every triangle in the truss is pushed against each other member. This compression or tension is what provides strength to the truss. The designer/engineer at AAA determines the loads that the entire roof will

place on each member comprising an individual truss and selects the size of the wood and method of framing necessary to support the load. There are numerous possible designs of the individual truss. Its shape and construction are governed by the overall design of the roof and of the house's walls and interior beams on which the roof system rests. Thus, the truss required varies with each house design.

A wall panel is the structure that forms and supports the weight of a wall. It is comprised of top and bottom plates and studs.

Floor decking structures are substantially similar to the wall panel structure.

The stair structure is different for each home based on the design of each home.

The builder's architect designs the house and prepares the basic architectural drawing for the roof truss system, walls and flooring. In the case of the roof truss system, the architectural drawing would indicate the roof's dimensions and the type of roofing material, such as asphalt or cedar shingles, to be used. The architect provides its drawing to AAA.

Draftsmen employed by AAA use the architectural drawing to prepare engineering drawings which show the exact materials, dimensions and method of fabrication to be used in fabricating the components. The draftsmen use a computer software program to assist in the design. AAA employs an outside engineering service to affix a required professional engineer's seal to the engineering drawing. The engineering drawing is submitted to the builder and to the local building code enforcement authority for final approval. Even though a professional engineer is contracted to affix his seal, at no time does AAA relinquish its responsibility for the integrity of the structure.

Once the engineering drawing is finally approved, it is used in AAA's facility to guide the craftsmen who fabricate the components.

AAA customers are the construction builders of new homes. Typically, a development of new homes has several models from which purchasers may choose, thus many homes are similar. However, each model is available in several elevations and as a result the exterior of the houses differs. One of the features that distinguish one elevation of a particular model from another is the roof dimension provided by the roof truss system. The roof truss systems vary from model to model and from elevation to elevation. The individual trusses which comprise the roof truss system may be duplicated many times but it would be highly unusual for AAA to fabricate more than fifty identical roof truss systems regardless of the number of new homes in a development. The process for the other components is substantially identical to that for fabricating roof truss systems. The components are fabricated for each individual home. There is somewhat less engineering that goes into the creation of the other components as compared to a roof truss system because of the weight transfer issues with a roof truss system. However, AAA must design and fabricate each component for each particular elevation and home design. Typically, homes vary from one subdivision to another, and the components made for one builder cannot be used for another. AAA can not and does not create 'stock' or 'standard' building components.

In researching whether or not AAA's fabrication business should be taxed under the Service Occupation Tax Act or the Retailer's Occupation Tax Act, we read 86 Ill. Admin.

Code §130.2115 which states that sellers of machinery, tools, dies, jigs, patterns, gauges and the like are subject to the Service Occupation Tax rather than the Retailers' Occupation Tax if the following conditions are met:

- the purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;
- the property has use or value only for the specific purpose for which it is produced, and
- the property has use or value only to the purchaser .

Additionally, the Regulation states that the requirement for designing property or special orders will be satisfied if the seller makes a substantial contribution to the designing of the property that is to be produced on special order and sold. Additionally, the Regulation states that if these conditions are met, a single order or simultaneous orders by the same customer of less than fifty identical items will still be subject to the Service Occupation Tax.

In our interpretation of the Regulation and applying it to the facts of AAA' business, it is our position that AAA should not be liable for Retailer's Occupation Tax, but instead be subject to treatment under the Service Occupation Tax. The builders employ AAA because of its skill and ability to design and produce the housing components. AAA creates the components for the specific needs of the particular purchaser. The components must be designed and constructed precisely to fit the dimensions of a particular design of a home, and thus the components have no value to any other purchaser. In Walters v. Department of Revenue, 44 Ill.2d 95 (1969), the Supreme Court determined that a sheet metal fabricator qualifies for Service Occupation Tax treatment when it fabricated products on the special order of its customer. The customer created a design but the taxpayer had to take field measurements and prepare working drawings. The court noted that 90% of the taxpayer's jobs required design work by him and that the taxpayer's charges for labor were more than double its charges for material. The court held that 'there is not strict requirements that the taxpayer conceive the item sold, or design it without direction from the buyer.' The court concluded that the requirement of 'the seller's design contribution' can be inherent in his skillful and experience manner of engineering an item.' 44 Ill2d. 95, 103.

Additionally, AAA makes a substantial contribution to the design and production of the components. AAA employees and subcontractors must prepare the detailed engineering drawing from which the components are manufactured and AAA must assume responsibility for the structural integrity of the components. In Private Letter Ruling No. ST 97-0016 which deals with a seller of house components, the seller in the letter ruling operated similarly to AAA in that architectural drawings were provided to the seller who through the use of its employees or subcontractors created detailed engineering drawings. The Illinois Department of Revenue found that the seller was employed primarily for its engineering or other scientific skill to design and produce the roof trusses and wall panels. The Department also noted that this finding was not affected by the fact that the seller may subcontract out the engineering work to someone else as long as the seller was contractually responsible for the engineering work.

For your convenience, we have attached PLR ST97-0016, which we have referred to above and in which the Department ruled that the taxpayer is liable for the Service Occupation Tax rather than the Retailer's Occupation Tax. Similarly, we would appreciate the issuance of a ruling confirming that AAA is liable for the Service Occupation Tax and not the Retailer's Occupation Tax. If you have any questions or need additional information, please contact me.

The issue of whether a person incurs a Retailers' Occupation Tax or Service Occupation Tax liability depends upon the nature of the items being produced and the nature of the design work involved. If the item being produced is substantially similar to stock or standard items, even though custom-made, the sale of that item would result in Retailers' Occupation Tax liability. The test for special order items that result in Service Occupation Tax liability is set forth in subsection (b) of the enclosed copy of 86 Ill. Adm. Code 130.2115.

The seller of a special machine, tool, die, jig, pattern, gauge or other similar item is engaged primarily in a service occupation, rather than in the business of selling tangible personal property, and so does not incur Retailers' Occupation Tax liability with respect to the sale, if the following tests for exemption are all met in the transaction:

- A) The purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;
- B) the property has use or value only for the specific purpose for which it is produced; and
- C) the property has use or value only to the purchaser. 86 Ill. Adm. Code 130.2115(b).

If a manufacturer of customized wall panels and roof and floor trusses is employed to provide engineering or other scientific skill to design and produce the customized wall panels and roof and floor trusses on special order for the purchaser in order to meet the particular needs of the purchaser, and those wall panels and roof and floor trusses have no value to others than the purchaser for the purpose for which they are produced, then the manufacturer will incur Service Occupation Tax liability on the sale of those customized wall panels and roof and floor trusses, rather than Retailers' Occupation Tax liability.

As to the requirement that the seller be employed primarily for his engineering or other scientific skill to design and produce the property, it is sufficient if the seller is responsible for making a substantial contribution to the designing of the property that is to be produced on special order. See subsection (b)(2) of Section 130.2115. A manufacturer who takes a customer's blueprints and prepares its own drawings that set out the materials, dimensions, and the method of manufacture necessary to create customized wall panels and roof and floor trusses and then uses those drawings to manufacture the customized wall panels and roof and floor trusses is generally responsible for making a substantial contribution to the designing of the property that is to be produced on special order as long as the manufacturer is contractually responsible for the engineering of those panels and trusses. This is not affected by the fact that the manufacturer may subcontract out the engineering work to another as long as the manufacturer is contractually responsible for the engineering work.

We can not ascertain from the limited amount of information in your letter what your specific tax liability would be were these items considered special order items. The purchase of tangible

personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen use to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Please note that if a manufacturer constructs and sells 50 or more identical trusses or wall panels in a single repeat order or simultaneous orders from a user (so-called multiple orders), those sales will be deemed to be volume production and will be subject to Retailers' Occupation Tax (rather than Service Occupation Tax) liability based on the total amount received by the manufacturer from such volume production orders. Also, even items that qualify for exemption from the Retailers' Occupation Tax, if sold subsequently without material change to the purchaser for use (so-called repeat orders), will become subject to the Retailers' Occupation Tax because the skill that is involved after the first item is made is production skill and not specialized engineering and design skill. See 86 Ill. Adm. Code 130.2115(a)(4). If a manufacturer also makes retail sales of tangible personal property, such as plywood and other non-manufactured products, that manufacturer will incur Retailers' Occupation Tax liability on those sales.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.